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SUBJECT: SOUTH AFRICA: MINERALS AND ENERGY NEWSLETTER "THE ASSAY" - ISSUE 11

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¶1. (U) Introduction: In January 2004, the Economic Section of Embassy/Pretoria produced the first issue of a new monthly newsletter called "The Assay". The purpose of this monthly newsletter is to highlight minerals and energy developments in South Africa. This includes trade and investment as well as supply. South Africa hosts world-class deposits of gold, diamonds, platinum group metals, chromium, zinc, titanium, vanadium, iron, manganese, antimony, vermiculite, zircon, alumino-silicates, fluorspar and phosphate rock, and is a major exporter of steam coal. South Africa is also a leading producer and exporter of ferroalloys of chromium, vanadium, and manganese. The information contained in the newsletters is based on public sources and does not reflect the views of the United States Government. End introduction.

Key

¶2. (U) Key to some of the terminology and abbreviations used is given to facilitate understanding.

BEE (Black Economic Empowerment) - the scheme whereby the South African Government promotes black participation in business.

- t = tons,
- t/d = tons per day,
- c/l = cents per liter,
- t/m = tons per month,
- t/y = tons per year,
- oz = troy ounces (31.1 grams),
- cmg = centimeter grams,
- mcf = million cubic feet,
- tcf = trillion cubic feet,
- R = SA currency (rand),
- MW = megawatts,
- kt = thousand tons,
- bbl/d = barrels per day,
- MW = megawatts,
- PGM = platinum group metals.

HOT ISSUES

ISPAT ISCOR Looks for a Power Alternative

¶3. (U) According to Bateman Africa, ISPAT ISCOR is planning to build its own power station in order to secure a future power supply and reduce pollution at its Vereeniging Steel Works in Pretoria. Management is concerned that South Africa could run into a national base-load power shortage by 2010, which could have a detrimental effect on the company. If the ISPAT ISCOR project becomes a reality, it would be South Africas first industrial independent power producer and the first power station to be built in South Africa by Bateman, one of the top five engineering and construction companies in South Africa. The National Energy Regulator (NER) has already granted a license for the construction of the power station. Waste heat from the Vereeniging Steel Works would drive the planned 140 MW plant. BHP-Billion is investigating similar options for its Richards Bay and Maputo aluminum smelters, and its Samancor ferro-alloy plants. These operations are heavy users of electricity and generate huge amounts of process heat that could be recycled to generate additional electricity.

Rolling Over Slow Moving Spoornet

¶4. (U) The inability of South Africas rail parastatal, Spoornet, to grow with the economy and provide efficient service has caused a number of mining and manufacturing companies to resort to road transportation, and others to consider purchasing their own rolling stock. James Lennox, Chief Executive of the South African Chamber of Business, has publicly encouraged chamber members to get involved in the rail business because he thinks it would be good for them and

the economy. He argues that the economic benefits would include reducing transportation costs for customers and the more efficient use of rail assets.

¶5. (U) Because of the lack of rail capacity, iron and manganese ore producers have not been able to ride the current global commodity boom driven by China demand. Rail inefficiencies have also frustrated automobile manufacturers. As a result, two iron ore mining companies, Kumba Resources and Assmang, are now negotiating with the government for permission to buy their own rolling stock so that they are no longer dependent upon Spoornets limited ability to respond to growing demand. Kumba and Assmang are situated next to each other in the Northwest Province, and want to increase their exports to China through ports at Saldanha Bay and Port Elizabeth. Also on the table for these iron ore exporters is the construction of a new rail spur to Coega, where a new deep-water port is under construction some 20 km east of Port Elizabeth. Meanwhile, the automotive industry, largely based in Port Elizabeth, has indicated interest in investing in new rail capacity between the Port of Durban and Johannesburg.

¶6. (U) Bulk commodities such as coal, iron ore, manganese ore, steel, and ferro-alloys account for more than 70% of Spoornets business. Add motor vehicles to this and the total exceeds 80%.

MINERALS

Uranium Byproduct Worth its Weight in Gold

¶7. (U) Afrikander Lease (Aflease) is a junior gold mining company that operated a now mothballed gold mine in the North West Province where uranium was an important byproduct. The mine occurs in the Dominion Reef geological formation, which is older than the gold-rich Witwatersrand formation and has relatively high uranium values. The mine contains so much uranium, in fact, that commodity prices determined whether one called it a gold, uranium, or dual-metal mine. Over the past decade, Afrikander Lease operated the mine as a marginal gold producer. Last year, the company closed the mine due to high costs of operation associated with the strength of the rand. Since 2003, however, the price of uranium has risen by more than 37%, and this may give the mine a new economic lease on life as a uranium mine this time with gold as the by-product.

¶8. (U) Afleases infrastructure, inherited from AngloGold, is still in place, but requires repair. Chief Executive Neal Froneman said that by 2005 the mine could resume gold production and move toward exploiting South Africas largest deposit of "near available" uranium by 2006. The project could provide 4 million pounds of uranium oxide a year to a growing nuclear energy market. Froneman said that the United States, Canada, Britain, France, Switzerland, and Japan had already shown interest in the mines 330 million pound uranium resource, and current and future market and price fundamentals looked good. At full production, the mine would also produce 100,000 oz a year of gold as byproduct. The projected capital cost tostart up the open-pit mine is $27 million, resulting in a breakeven cost of $14 a pound of
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uranium oxide (i.e., yellow cake). The price of yellow cake is currently about $20 a pound.

DIAMONDS

De Beers and the Draft Precious Metals and Diamonds General Amendments Bill
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¶9. (U) De Beers has long struggled with the problem of how to align its diamond production and "supplier of choice" marketing strategy with the new Mineral and Petroleum Resources Development Act and BEE Mining Charter. One way would be to become more involved in creating a local cutting and polishing industry and supplying BEE companies with rough diamonds mined in South Africa. Government has put considerable pressure on De Beers on this score, which some believe may be behind the 8% royalty on diamond revenues proposed in the draft Royalty Bill and the 5% excise tax on all rough diamond exports proposed in the draft Precious Metals and Diamonds General Amendments Bill (the Diamond Bill). De Beers and the diamond industry oppose both these bills, but see the BEE writing on the wall.

¶10. (U) At the end of a two-day workshop to solicit the diamond industrys input into the draft Diamond Bill, Minister of Minerals and Energy Phumzile Mlambo-Ngcuka announced that De Beers had agreed to incorporate BEE requirements into its "supplier of choice" program. The "supplier of choice" program replaced De Beers old Central Selling Organization sight holder method that characterized its monopoly in rough diamonds until the late 1990s. Under the "supplier of choice" program, De Beers selects its

customers for their ability to promote and market diamond jewelry. It will now select its South African suppliers based also on their ability to meet BEE requirements as prescribed by the mining industry charter. The De Beers Diamond Trading Company (DTC), the successor to the Central Selling Organization, currently distributes to 14 "suppliers of choice" in South Africa, but has committed to add BEE
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suppliers and to facilitate the development of BEE diamond cutting and polishing businesses. Israel-based diamond consultant Chaim Even-Zohar, who coordinated the workshop, explained that De Beers would require its "suppliers of choice" to supply diamonds to BEE cutters and polishers. In a parallel move, De Beers invited the South African Government to take a 50% stake in its Diamdel rough diamond trading subsidiary that sells diamonds to small clients.

¶11. (U) The diamond industry in South Africa employs about 28,000 people, of which 13,000 are in mining, 300 in sorting and valuing, 2,100 in cutting and polishing, 3,000 in jewelry manufacturing, and 9,000 in retailing. Locally mined production is valued at about $1 billion, with $550 million worth of rough diamonds supplied to the South African market and a similar value of polished diamonds exported. De Beers operates as a worldwide wholesaler of rough diamonds, producing about 40 million carats worth $5.5 billion last year (about 62% by value of total world demand). Most of the rough diamonds come from Botswana, South Africa, and Namibia, but De Beers also purchased $800 million worth of diamonds from Russia last year.

Synthetic Diamonds Worry De Beers

¶12. (U) BHP-Billiton, the world's largest mining company, and De Beers, the worlds largest producer and distributor of rough diamonds, are concerned that synthetic diamonds might adversely impact their $57 billion retail diamond market for natural stones. In an attempt to protect the high mark- up on its product, De Beers wants jewelers to buy analytical machines that can distinguish the synthetic stones from natural diamonds; the difference is not otherwise discernable. Two U.S. companies, Apollo Diamonds (Boston) and Gemesis (Florida), produce synthetic diamonds with equipment that replicates the high pressures and temperatures found in the earth. These synthetic diamonds make up about 4% of annual diamond production, but only 0.3% by value since they are sold at much lower prices. Until recently, synthetic diamonds were mainly used for industrial purposes, such as in drill bits for oilrigs. However, new technology has enabled the production of larger and more impressive stones. Blackie Marole, the Managing Director of Debswana, the Botswana Government's joint venture with De Beers, recently said that the marketing challenge posed by synthetic stones was as great as that recently posed by conflict diamonds. Sales of rough diamonds grew 8% in the first half of 2004 after totaling $8.9 billion last year.

LIQUID FUELS

Biodiesel

¶13. (U) As the world price of crude oil climbs, the scientific community and the South African Government have begun to contemplate producing biodiesel from sunflower seeds or soya, and ethanol from maize and sugar cane. According to Andre Otto, Deputy Director for Renewable Energy at the Department of Minerals and Energy (DME), locally produced biodiesel could reduce imports of crude oil and act as a cushion against sharp increases in oil prices. Biodiesel might also create a viable market for South Africas new black farmers. The Department of Science and Technology, the South African Bureau of Standards (SABS), the South African Revenue Service (SARS), and the South African Petroleum Association want to propose an implementation plan to government in March 2005. Otto states that the aim is to supply 150 million gallons of biodiesel a year within 10 years, equal to about 8% of the countrys annual diesel consumption or 2.5% of total liquid fuel consumption. SARS says that there should be tax benefits given to farmers who grow crops to produce biodiesel. However, local automobile manufacturers are concerned about biodiesel quality, and have asked SABS to set acceptable standards.

¶14. (U) The greater fuel efficiency of new diesel engine
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technology from Europe has helped diesel car sales reach 10% of all new vehicle sales in South Africa. Econometrix senior economist Tony Twine believes that this could even rise to 40% by 2013. South Africans now pay about $3.00 for a gallon of gasoline.

Labor

AIDS Takes its Toll on Gold Miners

¶15. (U) Harmony Gold, the third largest gold producer in South Africa, estimated that AIDS would kill one third of the 41,000 workers it employs in South Africa. In its 2004 annual report, Harmony stated that the HIV infection rate among the company's workforce would peak this year at 33.9%. AngloGold Ashanti, the countrys largest gold producer, had an infection rate among its South African workers of 30.2%, according to Petra Kruger, head of the company's HIV/AIDS unit. Gold Fields, the second largest producer, has an estimated 28% infection rate among its workforce. The rate of infection among miners has placed a financial and healthcare burden on companies as they battle falling productivity among the sick and rising medical costs for their workers. Harmony estimated that the impact of HIV/AIDS on their cash flow would be in the range of $2 to $5 an ounce.

Russians Talk Minerals and Energy

¶16. (U) A large delegation of Russian officials met with their South African counterparts in Pretoria on November 17-
¶18. Heading the delegation was the Minister of Natural Resources, Yury Trutnev. One of the most important agenda items for South Africa was assuring a long-term supply of crude oil. In 2002, PetroSA, the state-owned oil company, bought crude oil from Russia in a once-off deal. PetroSA officials have since visited Moscow several times to discuss further purchases, but without success.

¶17. (U) Trutnevs visit could also signal interest in natural resource trade and investment by both countries. South Africa and Russia are leading producers of platinum group metals, gold, and diamonds. South African company sources said that this would depend on the resolution of disputes between South African companies and their Russian counterparts. The most notable of these is the refusal by the Russian mining company, Arkhangelskgeoldobycha (AGD) to honor the investment and licensing partnership agreement signed with the De Beers-owned company, Archangel Diamond Corporation (ADC). Other South African companies engaged in Russia include Mondis (Anglo American group) joint venture with the Syktyvkar paper and pulp mill, AngloGold Ashanti's recent $32 million purchase of shares in Trans Siberian Gold (a London-listed miner with projects in central and eastern Siberia, and Anglo Platinum's stake in a platinum deposit in the Urals, funded through Eurasia Mining (another London-listed miner).

¶18. (U) In the news, Anglo American recently sold its 20.3% holding in Gold Fields Limited, South Africas number two gold producer, to Norilsk, the giant Russian nickel and
d
palladium producer. Although Norilsk management stated that the purchase was purely for its portfolio, rumors persisted that they were positioning for a takeover of Gold Fields. Harmony may have beaten Norilsk to the punch, which is why Norilsk is now teaming with Harmony in a hostile takeover bid for Gold Fields.
FRAZER